

LAC

Report to the General Assembly

May 1999

**A Limited-Scope
Review of the
Residential Property
Tax Relief Program**



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A Limited-Scope Review of the Residential Property Tax Relief Program was conducted by the following audit team.

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Synopsis

Members of the General Assembly asked us to review the accuracy of property tax reimbursement requests submitted each year to the state by county governments, acting for their local school districts. Section 12-37-251 of the South Carolina Code of Laws requires the state to compensate school districts for revenue lost due to state-mandated reduction in school operating property taxes. Our findings are summarized as follows.

- ❑ The state does not audit school operating property tax reimbursement requests submitted by county governments for local school districts. As a result, there is reduced assurance that school district reimbursements paid by the state are based on accurate data (see p. 8).
- ❑ The practice of inflating tax rates to compensate for historically uncollectible taxes has caused the state to overcompensate counties for revenues lost due to residential property tax relief. Precise amounts for each county can be known only through field audits. However, based on total reimbursements from tax year 1995 through estimated tax year 1998, the state may have overcompensated counties as much as \$35.6 million. Factors employed by counties in setting tax levies for the school operating budgets are not consistent (see p. 11).
- ❑ According to officials of the Department of Revenue (DOR) and the Office of the Comptroller General (CG), there is not an adequate database for ensuring that the state pays only one school operating property tax reimbursement per homeowner. As a result, an individual with more than one home could obtain multiple exemptions with a low risk of detection (see p. 15).
- ❑ DOR has not proposed state regulations for the property tax relief program; instead, the department has issued official advisory opinions which may not be binding on local governments. By using opinions in lieu of regulations, the Department of Revenue has excluded the public and the General Assembly from participation. This may increase the likelihood that local governments would treat property tax issues in a manner inconsistent with the intent of the law, resulting in the state paying larger reimbursements than required (see p. 15).
- ❑ The statutes require the state to pay counties 90% of their property tax reimbursement by December 1 of the tax year. In the 1997 tax year, the last complete year of distribution, the state reimbursed property tax relief funds to the counties in accordance with time limits stipulated in the law (see p. 18).

- ❑ We found indications that some school districts may not be receiving property tax relief reimbursements in the year they are collected, as required by government accounting standards. Based on our sample, approximately \$594,000 may not have been distributed in FY 96-97 by counties to school entities and for FY 97-98 approximately \$1.7 million may not have been distributed. The failure to credit all property tax relief revenues affects the amount of funds the county is required by EIA to raise per pupil through property taxes (see p. 18).
- ❑ Constraints of the South Carolina Department of Education (SDE) accounting system make it difficult to ensure that property tax relief funds are spent on operations and not on bonded indebtedness or lease-purchase agreements for capital construction, as required by §12-37-251(A)(1) of the South Carolina Code of Laws. For FY 96-97, over \$33 million was transferred statewide out of the districts' general fund accounts to the debt service and school building funds. Since it would not be possible to trace these transfers through to expenditures, it would likewise not be feasible to identify instances where a district expended funds illegally (see p. 21).
- ❑ The state's process for reimbursing local governments for revenue lost through the residential property tax exemption is unnecessarily complicated, weakens accountability, and increases the potential for abuse (see p. 23).
- ❑ The two state agencies charged by law with administering the property tax reimbursement process, DOR and the CG's office, have assigned responsibilities that overlap or conflict with each other. Also, participation of a number of officials on both the state and local levels of government expands the need for oversight and, without proper controls, decreases accountability in the system (see p. 24).

Since this report contains recommendations concerning only one program in the complicated tax structure, our recommendations should not be considered alone, but as they relate to the overall goal of making a more workable and equitable system.

Introduction

Audit Objectives

Members of the General Assembly asked us to review the accuracy of property tax reimbursement requests submitted each year to the state by county governments, acting for their local school districts. These reimbursements are authorized by state law to compensate school districts for the revenues they lose as a result of state-mandated property tax relief granted to homeowners.

Our audit objectives were identified primarily through interviews and correspondence with the audit requesters, as well as through interviews with staff of the Department of Revenue, the Office of the Comptroller General, the State Department of Education, and various county and school district offices. We reviewed:

- Controls over the reimbursement process that could affect the accuracy of the requests for reimbursement.
- The process used to define which costs school districts pay for with reimbursement funds.

Scope

The scope of the audit is the property tax relief program from FY 94-95 through FY 97-98. We focused on §12-37-251 of the South Carolina Code of Laws and related statutes.

We did not review the homestead exemption program, in which a “legal residence” owned by a senior citizen or disabled citizen is exempt from taxes on the first \$20,000 of its value. In addition, we did not review state reimbursements to counties for business and manufacturing property tax exemptions (see p. 7). However, the processes involved in both the homestead exemption and the property tax relief programs are similar. Therefore, some recommendations in this report may also be applicable to the homestead exemption program.

Methodology

Methodologies used in our analyses are outlined in the report. We reviewed records of the Department of Revenue (DOR), Office of the Comptroller General (CG), State Department of Education (SDE), Board of Economic Advisors of the Budget and Control Board (BEA), and records of various county governments and school districts. We reviewed reports issued by the Governor's Advisory Committee on Tax Accountability and Reform, the Property Tax Relief Team, and the Joint Tax Study Commission. We also contacted a number of other states to determine how they manage their property tax relief programs.

Some computer-processed data were used to develop the report. We obtained special reports from the Office of the Comptroller General. Our policy is to rely on CG reports. We also relied on information from audited financial statements of school districts provided by SDE.

We designed our audit to avoid duplication with audits conducted by other qualified entities such as local independent CPAs. This audit was conducted in accordance with generally accepted government auditing standards.

Background and History

Beginning in 1994, numerous concerns regarding property taxes led the Governor and the General Assembly to study the issue.

- ❑ On October 1994, the Governor's Advisory Committee on Tax Accountability and Reform was chartered to review the system of administration and collection of the property tax and examine viable alternatives. In their report of January 1995, the committee found that property taxes had grown at a high rate because of a need for increased school funding. The committee recommended, as an alternative taxing method, that the state should collect the property tax from local taxpayers as a state tax and reconsider the method of distributing state funds. Finally, the committee emphasized that any proposed alternative to property taxes for school funding should be evaluated in terms of accountability and that there should be a special study of educational funding and accountability.

- ❑ The Property Tax Relief Act became effective in tax year 1995, and involved several levels of government and complex reimbursement processes. The General Assembly chartered a special team to develop strategies for preventing abuse of the Property Tax Relief Fund and for ensuring its long-term financial integrity. In its report, the team cited specific problems with the reimbursement processes and recommended solutions for them. Additionally, the team recommended that it continue to operate on a permanent basis. This would facilitate the working relationship among the agencies and entities involved in the reimbursement process, and provide a forum for the discussion of tax issues, interpretation of legislation, and procedural problems. However, the team has not met since its report was completed in May 1996.
- ❑ After repealing the Joint Tax Study Commission in 1991, the General Assembly reenacted it in June 1997. The commission's goals were to review the state's revenue laws and recommend changes in the tax structure to provide a revenue system that is equitable to citizens as well as competitive in attracting business.

In its report of January 1999, the commission stated that property tax reimbursement lacks accountability because it is collected by a government entity at one level and spent by one at a different level. The commission recommended that the Legislature clearly delineate the lines of responsibility between levels of government.

The report further recommends that the Legislature consider establishing an ongoing tax study commission to evaluate future tax proposals against the criteria developed by this commission. Unless the General Assembly acts to extend it, the existence of the current commission terminates after June 30, 1999.

Residential Property Tax Relief Program

In the 1995 tax year, the General Assembly provided under §12-37-251 of the South Carolina Code of Laws, an exemption to homeowners from paying part of the property taxes used to operate local schools. Counties are asked to determine the amount of reimbursement due from the loss of these funds, and request payment from the comptroller general. In turn, the funds are passed through the counties to the various school districts.

The residential property relief program has two major objectives.

- To lower property taxes paid by homeowners for the operating costs of school districts.
- To cause no reduction in school district revenues.

Statutes provide that the Trust Fund for Tax Relief contain an amount equal to that necessary to fully reimburse the school districts for the losses they incur as a result of homeowner exemptions. Reimbursements are based on school operating millage (tax rate) imposed for tax year 1995 or the current school operating millage, whichever is lower.

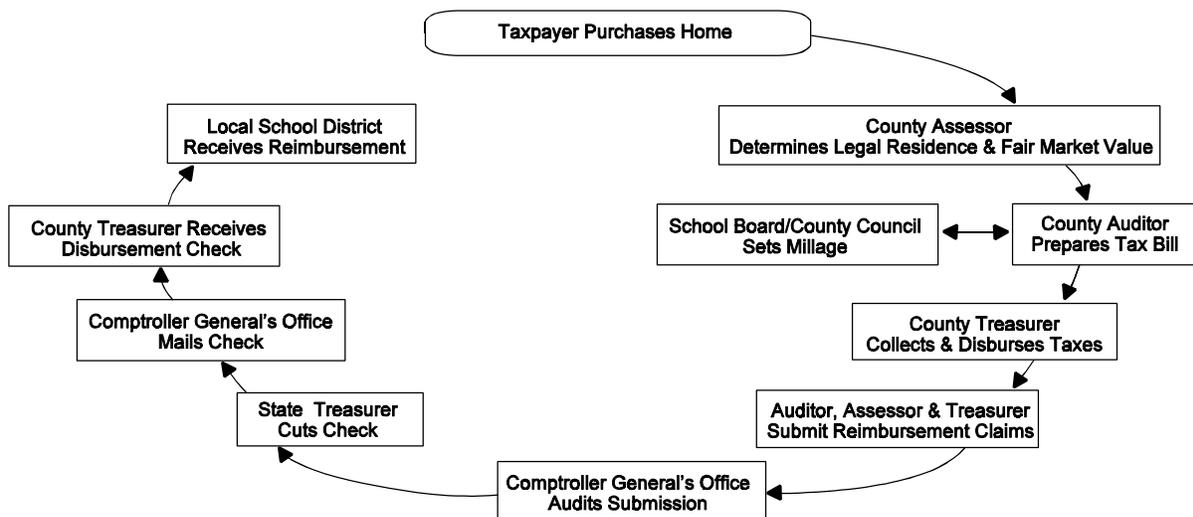
Description of the Reimbursement Process

The reimbursement process is as follows.

- An individual's home is categorized by the county government as a "legal residence" if it meets the definition in state law. The tax on a legal residence is $\frac{1}{3}$ lower than the tax on rental property of equal value.
- The county estimates the "fair market value" of the legal residence and multiplies the amount by 4% (the residential assessment rate) to calculate the "assessed value," which represents the taxable value of the residence.
- The county multiplies up to \$4,000 of the assessed value of the residence by the 1995 school operating property tax rate (millage). The product of this calculation is the amount paid by the state instead of the homeowner. Section 12-37-251 of the South Carolina Code of Laws generally requires that, when the school operating property tax rate in the current year is below the 1995 level, the homeowner's exemption should be calculated using the lower tax rate.
- The county submits to the CG a list of all homes that have received residential property tax exemptions, the data necessary to calculate the exemption, and the requested reimbursement. The CG mails the disbursements to the counties.
- County treasurers are responsible for transferring the property tax relief funds to the school districts.

The following flow chart outlines the reimbursement process. See Appendix A for a glossary of terms.

Chart 1.1: Property Tax Relief Reimbursement Process



Reimbursement Funding

Property tax relief funds, along with revenues from several other local and state sources, are used in support of the general fund or operating fund of the school districts. A district's general fund pays for salaries, supplies for instructional and support services for pupils, and for general administrative services. These include services for the board of education and the school administration, services such as operation and maintenance of the school physical plant and transportation, and data processing. State law prohibits school districts from using property tax relief funds in support of debt service or capital projects.

DOR is responsible for annually projecting the amount of funds that will be needed for the reimbursement. However, the exact cost of the exemptions can never be known in advance. Factors such as the number of houses that will receive the exemption, the specific tax rate of the school districts, or the value of the new homes cannot be known before the state budget is prepared because taxes are levied and totaled after the state budget process. Regardless, state law requires the state to pay any funds necessary for reimbursing the counties.

Since FY 95-96, the state has reimbursed the counties in the following amounts. Also see Appendix B for a breakdown by county of the funds disbursed by the state in FY 96-97 and FY 97-98.

Table 1.1: Property Tax Relief Reimbursements FY 95-96 Through FY 98-99*

Fiscal Year	Amount Reimbursed	Number of Homes	Average Reimbursement Per Home
1995-96	\$207,791,077	993,902	\$209
1996-97	\$216,942,851	1,031,801	\$210
1997-98	\$227,400,846	1,068,216	\$213
1998-99*	\$240,000,000	1,108,216	\$217
TOTAL	\$892,134,774	\$4,202,135	\$212

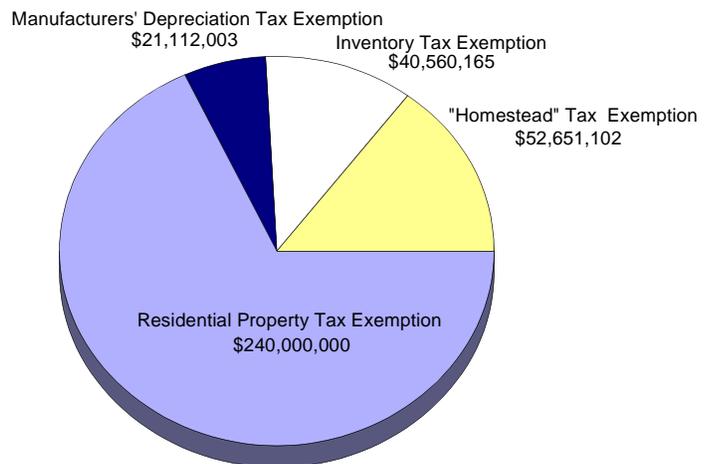
* Estimated.

Source: Comptroller General's Office.

Program Lacks Controls

In FY 98-99, the State of South Carolina will pay more than \$350 million in various property tax reimbursements to school districts, counties, and municipalities. About \$240 million of this total will be used to reimburse school districts for the school operating property tax exemption granted to all homeowners under §12-37-251 of the South Carolina Code of Laws.

Chart 2.1: Estimated State Tax Relief Disbursements to Local Governments for FY 98-99



Source: Office of the Comptroller General.

In this chapter, we address program processes and controls needed to ensure compliance with state laws governing the residential property tax relief reimbursement. We found that no state agency adequately oversees local compliance with laws governing the property tax reimbursement process or laws governing the expenditures of reimbursement payments.

No State Auditing of County Reimbursement Requests

The state does not audit school operating property tax reimbursement requests submitted by county governments for local school districts. As a result, there is reduced assurance that school district reimbursements paid by the state are based on accurate data.

Currently, the CG requires that the counties' reimbursement requests list for each home the owner's name, the tax map number, the fair market value, the assessed value, and the portion of the school property tax rate to be paid by the state. The CG also checks the counties' mathematical calculations.

No state agency, however, conducts audits of the data used to calculate the reimbursement requests. As a result, the state does not determine the following.

- Whether homes have been appropriately categorized as "legal residences."*

Rental homes are taxed at a rate 50% higher than owner-occupied homes and are not eligible for a residential property tax exemption.

- The accuracy of the fair market values assigned to homes.*

Inaccurate fair market values can result in property tax reimbursements that are not in compliance with §12-37-251 of the South Carolina Code of Laws (see p. 11).

- Whether the state is paying more than one reimbursement per homeowner.*

As noted on page 15, the state does not have an adequate database for detecting multiple reimbursements per homeowner.

- Whether the correct school operating property tax rate is being used to calculate the reimbursement.*

Under §12-37-251 of the South Carolina Code of Laws, the school operating property tax rate used to calculate reimbursements may not exceed the 1995 school operating property tax rate. When school operating costs can be funded with a property tax rate lower than the

1995 rate, reimbursements must usually be calculated using the lower rate. State law also requires that the rate used to calculate reimbursements be adjusted after property values have been reassessed.

- ❑ *Whether the school districts are spending reimbursements on operating costs only (see p. 21).*

Constraints of the South Carolina Department of Education (SDE) accounting system do not assure that property tax relief funds are spent on operations and not on bonded indebtedness or lease-purchase agreements for capital construction as required by §12-37-251(A) of the South Carolina Code of Laws.

- ❑ *Whether the counties or contractors working for the counties have adequate controls to ensure accuracy and deter fraud.*

State law appears to authorize audits by both the Department of Revenue and the comptroller general.

A majority of South Carolina counties contract with a private company to assist in the processing of property tax data. We identified contracts, however, that do not authorize access to company documents by state and local governments for the purpose of audit.

State law appears, however, to authorize audits by both the Department of Revenue (DOR) and the CG. For example, §12-4-520 (3) of the South Carolina Code of Laws states that DOR:

May visit any of the counties in the State to investigate the assessment, equalization, and taxation of all property subject to taxation and take any action necessary to insure the proper assessment, equalization, and taxation of the property.

Section 12-4-520 (4) of the South Carolina Code of Laws states that DOR:

As often as annually, shall examine all the books, papers, and accounts of assessors, auditors, treasurers, and tax collectors, with a view to protecting the interests of the State, counties, and other political subdivisions and rendering these officers aid or instruction . . .

If the state government were to institute periodic formal audits of the data submitted in property tax reimbursement requests, there would be a reduced likelihood of improper payments from the state.

Section 12-39-320 of the South Carolina Code of Laws states that the CG :

. . . shall, as often as once a year, either in person or by some authorized agent of his office examine all the books, papers, and accounts pertaining to the offices of the auditors and the treasurers of the respective counties, with a view to protecting the interests of the State and rendering such officers such aid or instruction as, in the discharge of their several duties, they may need to make their service the more efficient.

If the state government were to institute periodic formal audits of the data submitted in property tax reimbursement requests, there would be a reduced likelihood of improper payments from the state. In addition, counties and school districts would be more likely to act in a consistent manner. It is important to note, however, that for auditing to be effective, the method for calculating reimbursement requests should be clearly stated in law and regulation (see p. 15).

Recommendations

1. The General Assembly should consider amending state law to clearly designate and require a single state agency to conduct periodic field audits of the data submitted by county governments in property tax reimbursement requests.
2. The General Assembly should consider amending state law to require that county contracts with data processing companies authorize access to company documents by state and local governments for the purpose of auditing.

Reimbursement Requests Based on Inflated Millage Rates

Background

Factors employed by counties in setting tax levies for the school operating budgets are not consistent and may affect the amount of the reimbursement the state pays. However, the practice of inflating millage rates has perhaps the greatest impact on the amount of the reimbursement paid by the state. The state has overcompensated counties for revenues lost due to residential property tax relief. From tax year 1995 through estimated tax year 1998, the state may have overcompensated as much as \$35.6 million.

The South Carolina Supreme Court described the process for determining individual property taxes in its 1982 County of Lee v. Stevens decision:

There are two elements to any property tax system: (1) the tax rate, and (2) the property value. Tax rate is generally reflected in 'mills,' or 'millage rate.' A mill is simply a unit of monetary value equal to one tenth of a cent, or one thousandth of a dollar A tax rate of 150 mills translates into .15 (15 cents) tax per \$1.00. Property value involves 'actual value' and 'assessed value.' Actual value simply denotes the true market value of the property. Assessed value is a valuation placed upon property for the purpose of taxation It is normally a small fractional part of the actual value [based on the property classification and assessment ratio which are provided in §12-43-220, Code of Laws of South Carolina. This authority must be exercised based upon property valuations to be used for the ensuing year.]

Individual property taxes are determined by multiplying the tax rate (millage) times the assessed value of the particular property [T]he appropriate tax rate [or millage] is reached by dividing the assessed value of the property to be taxed into that part of the budget to be generated by property taxes. [The Supreme Court of South Carolina held the authority to set the tax rate belongs to the county governing body.]

Calculation of the Reimbursement

According to §12-37-251(A)(1) of the South Carolina Code of Laws, the 1995 tax year school operating millage or the current school operating millage, whichever is lower, is the base year millage for calculating the amount of reimbursement the state will pay to the counties.

County governing bodies generally rely upon information supplied to them by the county auditors when setting the tax rates. The total assessed valuations of real (residential and manufacturing) and personal property in the county is typically relayed to the body with authority to set the tax rate.

South Carolina Code §12-43-220(c)(1) allows a 4% assessment ratio for a taxpayer's “. . . legal residence and not more than five contiguous acres thereto” This assessment ratio is applied to a fair market value amount no greater than \$100,000. Therefore, the property tax relief generally afforded taxpayers in any given tax year is illustrated in Table 2.1.

Table 2.1: Example of Method for Calculating Property Tax Relief

Fair Market Value	Residential Assessment Ratio	1995 School Operating Tax (Millage) Rate	Property Tax Relief
Up to \$100,000 X	4% X	Tax Rate =	PTR

The applicable 1995 school operating millage rates may vary among and within South Carolina's 46 counties.

County Practices

In arriving at the reimbursement request to be presented to the state, counties generally follow certain steps. According to county officials, these practices were in effect for establishing all millages from tax years 1995 – 1997.

- Determine the fair market value of the county's real and personal property and apply appropriate assessment ratios to arrive at the assessed value.
- Multiply the assessed value by a factor for uncollectible taxes.
- Multiply the above product by .001 to determine the value of a mill.
- Divide the school operating budget by the value of a mill to obtain the tax rate or millage.

Discounting the assessed valuation figure has the effect of inflating the 1995 school operating millage rate.

Factors employed by counties in completing these steps are not consistent and affect the assessed valuations of real and personal property. For example:

- Some counties' assessed valuations are based on data that are two years old. This could cause a county to underestimate its assessed values and therefore lead to the establishment of a millage higher than necessary, resulting in a windfall.
- Some counties apply a growth factor to their assessed valuation.
- Some counties make adjustments pertaining to motor vehicle assessments in order to compensate for the overlap between the fiscal and calendar years.

However, the practice of inflating millage rates to compensate for historically uncollectible taxes has had perhaps the greatest impact on the amount of the reimbursement the state pays. Collection rates vary among the counties; in our survey, we found rates varied from 88% to 98%. According to an official in the comptroller general's office, the collection rate used is generally 96%. Discounting the assessed valuation figure has the effect of inflating the 1995 school operating millage rate, as illustrated in Table 2.2.

Table 2.2: Hypothetical Effect of Discounting the Assessed Property Valuation Figure on the 1995 School Operating Millage Rate

	Collection Rate X \$100 Million Assessed Value	Millage Conversion Factor	Budget ÷ Mill Value	1995 School Operating Millage Rate
Full Collection Rate	\$100,000,000 X 1.00 = \$100,000,000	\$100,000,000 X .001 = \$100,000	\$10,000,000 ÷ \$100,000	100.00
Discounted Collection Rate	\$100,000,000 X .96 = \$96,000,000	\$96,000,000 X .001 = \$96,000	\$10,000,000 ÷ \$96,000	104.17

Conclusion

This situation occurred because §12-37-251 of the South Carolina Code of Laws did not account for the inflated millage rate in place in 1995. When local taxpayers were replaced with the fiscal strength of the state, it was no longer necessary to use a factor for uncollectible accounts in establishing the school operating millage rate, because the state will pay 100% of the school operating tax levy. However, the state has reimbursed local governments at the 1995 school operating millage rate, which was inflated in order to account for the taxes which were historically uncollectible. Precise amounts for each county can be known only through field audits (see p. 8). However, based on inflated school operating millages alone, the state may have overcompensated counties as much as \$35.6 million from tax year 1995 through estimated tax year 1998.

Moreover, as a result of the inflated reimbursement payments, some local governments may have realized a surplus. There are, however, no controls in place to ensure that county auditors use surpluses to offset school operating levies for the following year.

When the information submitted to governing bodies with authority to set the tax rates is not uniform, there may be inequitable variations in the taxing structure of local governments. In addition, when counties are reimbursed at an inflated millage rate, the state could be overpaying the school operating tax levy. Finally, the lack of controls over the use of surpluses by county auditors increases the risk that surpluses are not used in a consistent and uniform manner.

Recommendations

3. The General Assembly should consider amending §12-37-251 of the South Carolina Code of Laws to provide that the school operating millage used to obtain property tax reimbursements from the state is not inflated to account for historically uncollectible taxes.
4. The State of South Carolina should provide county auditors with uniform guidelines to ensure that all counties use the same components in calculating property tax reimbursement from the state.

No Statewide Taxpayer Database

According to officials of DOR and the CG, there is not an adequate database for ensuring that the state does not pay more than one school operating property tax reimbursement per homeowner.

Section 12-43-220 (c)(2) of the South Carolina Code of Laws restricts eligibility for the residential property tax exemption to one home per taxpayer. The state, however, does not require taxpayers to report their social security number or a similar taxpayer identification number. As a result, an individual with more than one home could obtain multiple exemptions with a low risk of detection.

Recommendation

5. The General Assembly should consider amending state law to require that homeowners report their social security numbers to county governments as a condition for obtaining state-funded property tax exemptions. If the General Assembly enacts this amendment, the Office of the Comptroller General should require that counties report homeowners' social security numbers when submitting property tax reimbursement requests to the state.

Lack of Formal Program Regulations

The South Carolina Department of Revenue (DOR) has not proposed state regulations for the property tax relief program. This may increase the likelihood that local governments would treat property tax issues in a manner inconsistent with the intent of the law, resulting in the state paying larger reimbursements than required.

DOR is responsible for providing guidance to local governments when determining which costs may be properly submitted to the state for property tax reimbursement. However, the department has not promulgated regulations through the Administrative Procedures Act (APA) to provide interpretation of various terms and sections contained in property tax relief statutes. In lieu of regulations, the department has issued official advisory opinions which they refer to as either revenue procedures or revenue rulings. According to DOR officials, the department has not promulgated regulations because the process is neither timely nor cost effective.

Since DOR rulings may not be binding on local governments, they may disregard DOR interpretations and circumvent the law.

The Administrative Procedures Act (APA), in §1-23-10 through §1-23-160 of the South Carolina Code of Laws, governs the manner in which regulations are promulgated. Section 1-23-10(4) states:

Regulation means each agency statement of general public applicability that implements or prescribes law or policy or practice requirements of any agency. Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law.

Before promulgation of a regulation, an agency must give notice in the state register and provide opportunities for the public to express opinions regarding the proposed regulations. The notice must also summarize what the agency plans to draft. Additionally, all regulations must be submitted to the General Assembly for review and approval.

Since DOR rulings may not be binding on local governments, they may disregard DOR interpretations and circumvent the law. Moreover, rulings are written by Department of Revenue attorneys, without input from either the General Assembly or the public. In addition, the general public and local school districts may have less access to the department's interpretations than they would to state regulations which are published as part of the South Carolina Code of Laws.

DOR has issued several revenue rulings and revenue procedures regarding residential property tax relief. For example, revenue ruling 97-4 addresses the definition of a taxpayer's "legal residence," and revenue ruling 96-6 interprets the terms "capital construction," "school," and "operations."

The definition and application of these terms is integral to the residential property tax relief program since they are the basis upon which requests for reimbursement should be calculated and properly submitted to the state. Some of these terms are addressed differently in various sections of the South Carolina Code of Laws. For example, "capital construction" is not defined in the code. However, definitions for three related terms, capital improvement, capital outlay, and construction, suggest the legislative intent of the term "capital construction." However, none of the definitions may be sufficient as none establishes a threshold dollar amount for capital construction costs. This situation could result in some schools categorizing a new roof as capital construction (which cannot be paid for with relief reimbursements) while others could categorize it as maintenance.

In addition, the Department of Revenue has not promulgated regulations clarifying the manner in which residential parcels located in tax increment financing districts (TIFs) should be addressed for property tax relief purposes. As a result, some taxpayers residing within these districts may have received property tax relief while others have not. TIFs are geographic areas where taxes are frozen and taxes derived from any increased market values of homes located in TIFs are used to pay the debt of the TIF rather than in support of the school districts; however, there is pending litigation on this issue (The Consolidated School District of Aiken County v. City of North Augusta, et al.).

During the course of the audit, we learned there were discussions between DOR and the CG regarding shifting responsibility for interpreting pertinent provisions of the property tax relief program to the Office of the Comptroller General. Additionally, during the final exit of this audit, DOR informed us it was withdrawing several revenue rulings and information letters involving property tax relief.

By using revenue rulings in lieu of regulations, the Department of Revenue has excluded the public and the General Assembly from participating in this process. It has also increased the risk that local governments will address property tax relief issues in a manner inconsistent with the intent of the law.

Recommendations

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6. The South Carolina Department of Revenue and the Office of the Comptroller General should adhere to the South Carolina Administrative Procedures Act in establishing statements of general public applicability regarding the Residential Property Tax Relief Program (South Carolina Code §12-37-251 *et seq.*). At a minimum, the several revenue rulings already in place should be addressed through the Administrative Procedures Act.
 7. The South Carolina Department of Revenue should promulgate regulations regarding the manner in which residential parcels located in tax increment financing districts should be addressed for property tax relief purposes.

Comptroller General Timely in Funds Distribution

South Carolina Code §12-37-251(B) requires the state to pay counties 90% of their property tax reimbursement by December 1 of the tax year. The counties then distribute the funds to the school districts. Financial records for the 1997 tax year show that the comptroller general's office mailed the 90% reimbursement payment by December 1 to all except three counties. Payment to these counties was delayed because they did not submit their reimbursement requests until after December 1. An official with the comptroller general's office explained that the law is interpreted to allow payment after the specified date under these circumstances.

According to the State Department of Education (SDE), school districts rely heavily on property taxes for their operating expenses and are therefore directly affected by the state's timetable for reimbursing property tax relief funds to the counties. In 1995, SDE reported that 50 of the state's 91 school districts anticipated various types of cash flow problems if they were not reimbursed until late December or early January. According to a survey conducted by the South Carolina School Boards Association, 12 school districts issued tax anticipation notices to carry them through the 1996 tax year. The survey data show, however, that for 1997-98 the property tax refund constitutes only 10% or less of operating funds for all except three districts.

The law does not specify when the state must pay counties the 10% balance of their reimbursement. We reviewed a sample of fifteen counties from around the state to determine when they received their final payment for the 1997 tax year. Twelve counties received the balance of the funds owed them in March or April 1998, and all of them received payment by June 1998.

Receipt of Revenues by Districts

There is inadequate assurance that county governments, which collect property taxes for school districts, are transferring to the school districts all property tax reimbursements in the year they are collected. Any failure to transfer funds would be a violation of government accounting standards and may increase the likelihood that some districts will not receive precisely the reimbursement paid by the state.

Also, the amount of reimbursement revenues affects the amount of local school funding the county is required by the EIA to raise per pupil through property taxes.

We reviewed the tax year 1996 and 1997 property tax relief reimbursements for all counties and compared them to the State Department of Education reports of audited district revenues for FY 96-97 and FY 97-98. We were unable to obtain reliable audited revenue data for school subdistricts that extend over county lines in 14 counties. From the remaining counties, we found indications that some revenues may not have been disbursed by the counties to the school districts in the year they were collected.

Based on data we reviewed, approximately \$594,000 may not have been distributed in FY 96-97 by counties to their school districts and for FY 97-98 approximately \$1.7 million may not have been distributed.

- ❑ In FY 96-97, six counties may have disbursed fewer funds to school districts, county boards and area vocational centers than they received in property tax relief reimbursement from the CG. Amounts ranged from \$6,827 to \$401,926. Additionally, four counties appear to have disbursed more residential property tax relief funds than they received from the CG. In one case a county may have disbursed over \$157,000 more to its school district entities than the county's state property tax relief reimbursement totaled.
- ❑ In FY 97-98, six counties may have disbursed fewer funds to school districts, county boards, and area vocational centers than they received in property tax relief reimbursement from the CG. Of these six, four appeared to have disbursed fewer funds for FY 96-97. Amounts ranged from \$31,706 to \$795,188. Additionally, three counties appear to have disbursed more residential property tax relief funds than they received from the CG. In one case a county may have disbursed \$168,639 more than the county's reimbursement totaled. Based on data we reviewed, the over reimbursements were not initiated because under reimbursements were made in the prior year.

Based on data we reviewed, approximately \$594,000 may not have been distributed in FY 96-97 by counties to their school districts and for FY 97-98 approximately \$1.7 million may not have been distributed.

Sections 12-37-251(B) and 12-37-270 of the South Carolina Code of Laws require that the comptroller general annually pay to the county treasurer for the account of the school district(s), a sum equal to the amount of taxes that was not collected for the school district(s). Additionally, governmental entities, including school districts, typically use the modified accrual basis of accounting. This system is recognized in Governmental Accounting and Financial Reporting Standards published by the Governmental Accounting Standards Board (GASB). These standards state:

When a property tax assessment is made, it is to finance the budget of a particular period, and the revenue produced from any property tax assessment should be recognized in the fiscal period for which it was levied

Revenues identified as collectible within 60 days of the year end are authorized to be recorded.

Currently the CG does not maintain records that show the actual disbursement the office made on behalf of each school district or school entity. Payments are recorded as a lump sum to the county. Therefore, the CG does not issue a schedule of payments to school entities that would inform them of the amount of property tax revenues disbursed to the counties on their behalf. If this information were provided, State Department of Education audit guidelines could require independent CPAs under contract by the districts to compare disbursements from the CG to the county against revenues recorded for the school district or entity and report any exceptions. Currently, districts generally recognize or record property tax relief revenues based on receipts from the county treasurer.

Additionally, the amount of reimbursement revenues affects the amount of funds the county is required under the Education Improvement Act (EIA) to raise per pupil through property taxes. State law requires that a school district's local revenue in the prior year be the base figure used to compute the amount of local revenue required for the Education Improvement Act (EIA) in the current year. Even if there is no net loss of reimbursement funds to the school district, the year-to-year fluctuation of reimbursement revenues may allow counties to reduce the amount of funds the county raises per pupil.

Recommendations

8. The State Department of Education should review the distribution of property tax relief funds for tax years 1996 – 1998 and reconcile cases where funds may have been disbursed inaccurately to school entities.
9. The comptroller general should issue to each district superintendent of schools or school entity a report of actual property tax reimbursements made annually to the county on behalf of the school district.

10. The State Department of Education should amend audit guidelines to require that independent CPAs, during annual financial audits of school districts, confirm that property tax reimbursements made by the comptroller general are transferred to school district accounts as soon as they are received by the county.
11. County treasurers should forward, as required by state law, property tax relief funds to school districts accounts as soon as they are received from the state.

Controls Over Reimbursement Expenditures

Constraints of the South Carolina Department of Education (SDE) accounting system make it difficult to ensure that property tax relief funds are spent on operations and not on bonded indebtedness or lease-purchase agreements for capital construction, as required by §12-37-251(A)(1) of the South Carolina Code of Laws. Expenditures cannot be tracked by source of funds and two conflicting compliance standards exist controlling expenditures of the funds.

First, §12-37-251(A)(1) of the South Carolina Code of Laws states the property tax exemption is based on:

... the school operating millage ... excluding taxes levied for bonded indebtedness and payments pursuant to lease purchase agreements for capital construction.

DOR interpreted this section through Revenue Ruling #96-6 which concludes:

In reading each sentence of Code Section 12-37-251(A) together, the Department concludes that the term 'operation' does not include expenditures for bonded indebtedness and payments pursuant to lease-purchase agreements for capital construction.

DOR informed us during the final exit of the audit that they were withdrawing Revenue Ruling #96-6.

In order to properly track expenditures from property tax relief revenues, the department would need to account for them separately. However, complicating this issue is the fact that these funds are used to replace part of the required local support the county must pay under the Education Finance Act (EFA) which has a more liberal expenditure requirement.

Under the terms of EFA (§59-20-50(1) of the South Carolina Code of Laws) as interpreted by SDE, after a district spends 85% of its state and local EFA funds on direct and indirect aid to students, districts may transfer remaining funds to any other account including the school building and debt service funds for expenditure.

According to SDE staff, it would not be feasible to establish a special account for property tax relief funds since they are part of the EFA funds. Reimbursement funds, therefore, must be deposited in a district's general fund along with other local, state and federal revenues. According to SDE, their audit guidelines ensure compliance with §12-37-251(A)(1).

However, since accounting procedures allow moneys from the general fund to be transferred to school building or debt service funds, and since the districts' general fund accounts do not permit expenditures to be tracked by source of revenue, it is not possible to trace these transfers through to expenditures. Therefore, it would likewise not be feasible to identify the revenue source for instances where a district expended funds on capital construction or debt service.

For FY 96-97, over \$33 million was transferred statewide out of the districts' general fund accounts (excluding EIA funds) to the debt service and school building funds (see Appendix C).

Recommendation

12. The South Carolina Department of Education should seek clarification from the General Assembly as to how compliance standards should apply to expenditures from property tax relief funds, in order to ensure that accounting controls are appropriate.

Program Processes Overly Complex

Property taxes have a major impact on South Carolina's homeowners. The state should therefore make every effort to ensure that reimbursement procedures are standardized and consistently monitored. As discussed in this chapter, alternative methods employed by other states, such as homeowners' tax credits, can accomplish this objective with less government bureaucracy. In the past five years, two separate tax study committees have recommended that South Carolina's property tax reimbursement process be simplified and made more accountable.

Factors Contributing To Complexity

The state's process for reimbursing local governments for revenue lost through the residential property tax exemption is unnecessarily complicated. This weakens accountability and increases the potential for abuse of the Property Tax Relief Fund. Major factors contributing to the complexity of the reimbursement system are discussed below.

Multiple Agencies/Entities Involved

Four state agencies play a part in the reimbursement process.

- The Department of Revenue annually estimates for the Legislature the revenue appropriation necessary to fund the exemption.
- The comptroller general's office processes each county's claim for its share of the reimbursement, and the reimbursement check is cut by the State Treasurer.
- The State Department of Education audits each school district for compliance with regulations governing how the reimbursement revenue is to be spent.

In addition, officials from two local government entities, the county and school district, are involved.

- The county assessor determines the amount of revenue the county has lost as a result of the property tax exemption and is therefore owed in reimbursement from the Property Tax Relief Fund.

- ❑ The county auditor prepares the tax bill for property tax relief credit based on the operating millage submitted by the local school district(s).
- ❑ The county treasurer submits the property tax relief claim to the CG's office and, upon receipt of the reimbursement, transfers the funds to the local school district(s).
- ❑ The school district sets the operating millage to be used in calculating the reimbursement amount (the county council performs this function for school districts that are not independent).

Participation of a number of officials on both the state and local levels of government expands the oversight responsibility and, without proper controls, increases the potential for a lack of accountability in the system.

Overlapping Responsibilities

The two state agencies charged by law with administering the property tax reimbursement process, DOR and the CG's office, have assigned responsibilities that overlap or conflict with each other. As a result, local government officials are not certain about which agency to call when they have a procedural question or a complaint. Furthermore, as pointed out by an official with the CG's office, conflicting statutes exist as to which of the two agencies is responsible for examining the accounts of county auditors and treasurers. The official cited this as an example of the state's complicated property tax laws that raise many legal questions as to jurisdiction and emphasize the need for recodification.

Generally, the DOR has had jurisdiction over the assessment of property for tax purposes, while the CG's office has supervised the collection of taxes. Legislation enacted in 1990 and 1991 expanded the responsibilities of DOR and reduced those of the CG. For example, many duties of county treasurers and tax collectors, once the exclusive responsibility of the CG's office, are now under the jurisdiction of the DOR. Statutory changes have clearly shifted the supervision of these local functions from one agency to another. For other functions, the statutes are vague concerning the division between assessment and collection; for example, the two agencies share responsibility for monitoring tax refund duties of county tax collectors.

Prior to FY 94-95, DOR and the CG's office drew up a written agreement intended to clarify their respective areas of responsibility, establish standard administration procedures, and assist local officials in performing their duties. The agreement divides supervisory responsibility for specific duties of county treasurers, auditors, and tax collectors between DOR and the CG's office. According to DOR officials, however, this document has never been signed and distributed.

In its 1999 report, the Tax Study Commission asserted that the operation of the system on two levels of government makes its accountability more problematic and therefore requires more formal delineation of the lines of responsibility at each government level.

Previous Recommendations

As discussed earlier in this report, the Legislature has directed two different committees in the past five years to review and recommend changes in the state's property tax reimbursement system. In 1996, the Property Tax Relief Fund Team recommended that the state implement a clearly-defined set of guidelines and audit procedures to protect the integrity of the fund. In its 1999 report, the Tax Study Commission asserted that the operation of the system on two levels of government makes its accountability more problematic and therefore requires more formal delineation of the lines of responsibility at each government level.

Both teams recommended the establishment of a permanent oversight committee to facilitate the working relationship among the agencies and entities involved in the reimbursement process. The committee would also provide an ongoing forum for the interpretation of legislation, and the discussion of tax issues and procedural problems. As of May 1999, there is no permanent committee.

Alternatives to the Current Reimbursement System

The property tax traditionally provides a stable source of revenue for schools. According to a national survey, however, taxpayers consider it one of the most unfair forms of taxation. Therefore, most states make an effort to provide some form of property tax relief to their citizens.

Programs commonly employed by other states either reduce property tax bills directly, as in South Carolina, or give rebates to taxpayers in the form of income tax credits. Homeowner's exemption programs may or may not be based on local government assessments, and they may include varying degrees of monitoring functions.

- ❑ California provides a state-financed homeowner's exemption administered primarily by one state agency, the State Board of Equalization. At least once every five years, the board audits the practices of each county assessor, and each year it appraises a sample of county assessment rolls to determine compliance with statutory standards.
- ❑ Oklahoma grants a property tax exemption for homeowners according to local government assessments. As the state agency exclusively responsible for administering the program, the Tax Commission oversees the procedures of local officials, including auditing the accuracy of county claims and school levies.
- ❑ Indiana's state-funded property tax exemption for homeowners relies on local government assessments that are reviewed by the State Board of Tax Commissioners. The State Board of Accounts conducts an annual audit of each county, which includes a review of the county's budget and its calculations of tax funds due from the state.
- ❑ Wisconsin compensates its local governments for lost property tax revenue by distributing a school levy tax credit to each municipality according to its share of school taxes levied at the state level. The property tax reduction for each taxpayer is determined at the state rather than local level.

In programs featuring tax rebates, homeowners pay the full amount of their property taxes, and the state then grants them either a certain percentage or a fixed credit, usually on their income taxes. This type of system is generally administered at one level of government.

- ❑ In 1997, Minnesota passed legislation providing a \$500 million one-time property tax rebate by means of an income tax credit. The rebate represented 20% of 1997 property taxes paid by homeowners.
- ❑ New Jersey's property tax rebate program provides to homeowners a fixed annual income tax credit financed directly from state revenues. There is no reimbursement to local governments related to the rebate.
- ❑ In addition to its property tax exemption, Indiana returns to all homeowners a percentage of their property taxes through an annual state income tax credit. The credit varies according to the homeowner's annual income.

According to criteria set forth by South Carolina's Tax Study Commission, reimbursement procedures managed entirely at one level of government are more accountable than those systems operating at two government levels.

Recommendations

13. If the General Assembly decides to retain the current property tax relief system, it should consider amending state law to clearly delineate areas of jurisdiction for the Department of Revenue and the Office of the Comptroller General. All agencies involved should implement standard procedures and consistent controls in administering the mechanics of the reimbursement process.
14. The Joint Tax Study Commission should review alternative systems used in other states with the objective of simplifying South Carolina's residential property tax relief process and making it more efficient and accountable.
15. The General Assembly should consider establishing a tax study commission on a permanent basis to review future tax legislation and to provide a forum for tax issues.

Chapter 3
Program Processes Overly Complex

Appendices

Appendices

Glossary of Terms

Assessed Value — a valuation placed upon property for the purpose of taxation. It is normally a small fractional part of the actual value.

Capital Construction — The building, remodeling, improving, or demolishing of a school building or facility or the cost of acquiring land to construct a school building or facility. This term also includes fixtures permanently affixed to the building, such as central heating, built-in refrigeration in the cafeteria, central air conditioning, elevators, lighting fixtures, plumbing, and other improvements. Routine repairs that are to maintain a building in operating condition, and do not increase the useful life of the building are not included in the meaning of “capital construction.”

Fair Market Value — the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.

Mill — a unit of monetary value equal to one tenth of a cent, or one thousandth of a dollar. A tax rate of 150 mills translates into .15 (15 cents) tax per \$1.00.

Operations — Expenses of a school district which support salaries, supplies for instructional and support services for pupils, and for general administrative services. They do not include expenditures for bonded indebtedness and payments pursuant to lease-purchase agreements for capital construction.

School District — any area or territory comprising a legal entity, whose sole purpose is that of providing free school education, whose boundary lines are a matter of public record, and the area of which constitutes a complete tax unit.

Tax Increment Financing District — A taxing district structured so that the increase in tax revenues above what was collected prior to the creation of the taxing district pays for redevelopment of a blighted area.

Residential Property Tax Reimbursements Paid by the State

County	FY 95-96	FY 96-97
Abbeville	\$1,160,052.06	\$1,196,952.47
Aiken	\$7,223,531.36	\$7,469,504.45
Allendale	\$345,736.55	\$350,747.75
Anderson	\$9,322,346.45	\$9,618,987.27
Bamberg	\$681,307.42	\$701,782.38
Barnwell	\$849,418.86	\$876,954.39
Beaufort	\$6,430,304.73	\$6,650,956.99
Berkeley	\$6,665,217.90	\$6,970,841.90
Calhoun	\$633,457.06	\$672,828.64
Charleston	\$14,577,316.32	\$14,935,768.50
Cherokee	\$2,464,943.97	\$2,720,520.84
Chester	\$1,752,311.30	\$1,846,654.00
Chesterfield	\$1,562,635.62	\$1,618,189.56
Clarendon	\$969,442.64	\$1,007,283.97
Colleton	\$1,416,315.08	\$1,609,120.90
Darlington	\$3,181,105.20	\$3,323,487.41
Dillon	\$867,264.00	\$912,441.00
Dorchester	\$6,609,842.41	\$6,866,429.57
Edgefield	\$1,428,851.71	\$1,471,715.61
Fairfield	\$1,297,436.73	\$1,338,494.37
Florence	\$4,768,735.73	\$5,093,835.80
Georgetown	\$3,914,987.10	\$4,308,358.15
Greenville	\$19,852,171.84	\$20,465,073.27
Greenwood	\$3,794,625.15	\$3,739,112.59
Hampton	\$1,207,394.34	\$1,258,290.39
Horry	\$9,568,800.18	\$10,321,519.71
Jasper	\$820,981.41	\$857,690.74
Kershaw	\$3,425,820.27	\$3,560,706.78
Lancaster	\$3,513,620.65	\$3,588,171.64
Laurens	\$2,593,809.24	\$2,734,528.44
Lee	\$619,090.61	\$640,784.64
Lexington	\$19,705,798.61	\$20,674,596.04
McCormick	\$290,552.00	\$323,018.00
Marion	\$1,575,548.40	\$1,639,312.27
Marlboro	\$754,067.60	\$831,705.35
Newberry	\$2,017,266.70	\$2,105,759.55
Oconee	\$3,440,382.79	\$3,512,319.17
Orangeburg	\$4,636,984.15	\$5,703,730.74
Pickens	\$4,868,805.35	\$5,097,705.71
Richland	\$23,514,467.85	\$24,755,635.19
Saluda	\$980,865.38	\$993,906.12
Spartanburg	\$15,226,300.95	\$15,850,159.82
Sumter	\$3,606,639.02	\$3,731,252.06
Union	\$1,388,444.93	\$1,407,579.32
Williamsburg	\$1,127,624.11	\$1,141,476.87
York	\$10,290,229.26	\$10,904,955.20
TOTAL	\$100,150,497.60	\$105,636,596.13

FY 96-97 School District Transfers*

District	Debt Service Fund Transfer	School Building Fund Transfer
Abbeville	0	0
Aiken	0	0
Allendale	0	1,002
Anderson 1	0	0
Anderson 2	0	0
Anderson 3	28,614	0
Anderson 4	0	0
Anderson 5	0	0
Bamberg 1	0	0
Bamberg 2	0	0
Barnwell 19	181,735	279,664
Barnwell 29	246,907	221,470
Barnwell 45	0	6,736
Beaufort	0	0
Berkeley	0	0
Calhoun	0	0
Charleston	0	317,550
Cherokee	0	500
Chester	0	301,485
Chesterfield	779,068	23,344
Clarendon 1	0	0
Clarendon 2	0	45,085
Clarendon 3	0	0
Colleton	0	5,900
Darlington	0	0
Dillon 1	17,492	0
Dillon 2	0	119,425
Dillon 3	0	0
Dorchester 2	134,947	0
Dorchester 4	0	0
Edgefield	0	0
Fairfield	840,000	110,251
Florence 1	0	0
Florence 2	0	0
Florence 3	0	1,212,501
Florence 4	3,824	0
Florence 5	0	7,410
Georgetown	485,253	0
Greenville	0	0
Greenwood 50	26,312	0
Greenwood 51	0	61,486
Hampton 1	112	0
Hampton 2	0	0
Horry	0	0
Jasper	0	0
Greenwood 52	0	38,070
<i>continued</i>		

District	Debt Service Fund Transfer	School Building Fund Transfer
Kershaw	0	745
Lancaster	0	986,534
Laurens 55	0	0
Laurens 56	0	0
Lee	0	0
Lexington 1	4,443,478	0
Lexington 2	0	585,530
Lexington 3	0	0
Lexington 4	0	0
Lexington 5	0	0
McCormick	1,000	42,230
Marion 1	5,000	380,000
Marion 2	63	368,687
Marion 3	0	0
Marion 4	0	0
Marlboro	0	0
Newberry	0	62,760
Oconee	284,381	7,815
Orangeburg 1	0	0
Orangeburg 2	0	162,538
Orangeburg 3	0	1,350
Orangeburg 4	0	250,000
Orangeburg 5	681,941	0
Orangeburg 6	0	0
Orangeburg 7	0	19,627
Orangeburg 8	0	2,732
Pickens	0	175,000
Richland 1	0	0
Richland 2	0	0
Saluda	40,476	90,484
Spartanburg 1	936,367	56,658
Spartanburg 2	13,423	2,650,263
Spartanburg 3	0	316,471
Spartanburg 4	0	1,000,000
Spartanburg 5	1,578,254	2,072,305
Spartanburg 6	0	2,038,947
Spartanburg 7	0	4,210,423
Sumter 2	0	0
Sumter 17	0	200,000
Union	0	0
Williamsburg	0	62,961
York 1	0	1,500,000
York 2	0	2,390,000
York 3	0	0
York 4	0	0
TOTAL	\$7,984,383	\$19,634,060

* From General Funds to Debt Service and School Building Funds. Excludes Education Improvement Act Funds.

Agency Comments

Department of Revenue

May 20, 1999

Mr. George L. Schroeder
Director
Legislative Audit Council
400 Gervais Street
Columbia, SC 29201

Dear Mr. Schroeder:

Please find enclosed, DOR's comments to the facts and conclusions in "A Limited-Scope Review of the Residential Property Tax Relief Program" report. Similar to your report, we provide a summary of our comments and a more complete discussion of the 15 recommendations contained in the report.

If we can be of any further assistance, please advise.

Sincerely yours,

Elizabeth Carpentier
Director

Department of Revenue Response to Legislative Audit Council on A Limited-Scope Review of the Residential Property Tax Relief Program

Summary

- The Comptroller General's Office is the appropriate agency to promulgate any necessary regulations regarding the Property Tax Relief Program. Previously, the Department of Revenue (DOR) provided assistance to the Comptroller General's Office upon its request. A review of this and other programs was prompted by the recent leadership changes in the Department of Revenue and the Comptroller General's Office. The agencies determined that the CG's Office is the correct agency to administer all aspects of the Property Tax Relief Program, except for supervision of legal residency determination under §12-43-220(c)(1), school millage adjustments due to reassessments under §12-37-251(A)(1), certifications under §12-37-251(A)(2), and estimation of the tax relief reimbursement for the budget process under §12-37-251(F).
- The Legislative Audit Council's conclusion that school districts may have received a \$35.6 million windfall is without merit. The General Assembly clearly and specifically mandated reimbursement to the school districts at the 1995 school operating millage rate. Moreover, the General Assembly did so in 1996; it knew the 1995 school operating millages. Accordingly, it would be highly improper for any agency to promulgate regulations that would result in a millage rate different from that directed by the legislature.

Recommendation 1

The General Assembly should consider amending state law to clearly designate and require a single state agency to conduct periodic field audits of the data submitted by county governments in property tax reimbursement requests.

Response

DOR agrees with the concept of the recommendation. Based on Chart 1.1 on page 5 of the report, the agency responsible should be the Office of the Comptroller General.

DOR has provided draft legislation to the General Assembly providing for an independent annual audit of all political subdivisions authorized by law to levy property taxes. This independent audit would follow Government Auditing Standards, and the Comptroller General would publish manuals and guides setting forth the necessary items, transactions, and other areas to be audited. Once the audit report is received, the appropriate agency would follow up on any deficiencies found.

Recommendation 2

The General Assembly should consider amending state law to require that county contracts with data processing companies authorize access to company documents by state and local governments for the purpose of auditing.

Response

DOR concurs with this recommendation.

Recommendation 3

The General Assembly should consider amending §12-37-251 of the South Carolina Code of Laws to provide that the school operating millage used to obtain property tax reimbursements from the state is not inflated to account for historically uncollectible taxes.

DOR concurs with the recommendation, but strongly disagrees that any impropriety currently exists.

In its 1995 and 1996 deliberations, the General Assembly considered which school operating millage should be used. When the 1996 amendment capped school operating millages at the 1995 level, the General Assembly knew the millage rate for each school district. The Legislature **did not** add any prohibition to the school districts' use of any inflation factor for uncollectible taxes, despite 6 amendments in the statute's short history.

While the 1995 school operating millage rate was required by the legislature, DOR has the responsibility to prescribe how adjustments should be made in years of reassessment. DOR's prescribed method is found in Revenue Procedure 97-4. Revenue Procedure 97-4 **does not** allow any inflation factor for historically uncollectible taxes.

Recommendation 4

The State of South Carolina should provide county auditors with uniform guidelines to ensure that all counties use the same components in calculating property tax reimbursement from the state.

Response

DOR agrees that the Legislature should provide county auditors with uniform guidelines.

Recommendation 5

The General Assembly should consider amending state law to require that homeowners report their social security numbers to county governments as a condition for obtaining state-funded property tax exemptions. If the General Assembly enacts this amendment, the Office of the Comptroller General should require that counties report homeowners' social security numbers when submitting property tax reimbursement requests to the state.

Response

DOR concurs with this recommendation provided such use is in accordance with the Federal Privacy Act and the Social Security Act.

Recommendation 6

The South Carolina Department of Revenue and the Office of the Comptroller General should adhere to the South Carolina Administrative Procedures Act in establishing statements of general public applicability regarding the Residential Property Tax Relief Program (South Carolina Code §12-37-251 et seq.). At a minimum, the several revenue rulings already in place should be addressed through the APA.

Response

DOR is currently addressing appropriate use of advisory opinions, regulations, and statutory amendments. In this instance, however, the Office of the Comptroller General is the appropriate agency to promulgate any regulations regarding the Property Tax Relief Program. The Comptroller General has requested that DOR policy documents relating to the Property Tax Relief Program, except for school equivalent millage rate calculation, be withdrawn, which was done on May 6, 1999. DOR agreed to withdraw all those documents so that the Office of the Comptroller General can provide whatever guidance it considers necessary. The Department agrees that the school equivalent millage rate calculation should be made mandatory through the APA regulatory process, and DOR is beginning that process.

Recommendation 7

The South Carolina Department of Revenue should promulgate regulations regarding the manner in which residential parcels located in tax incremental financing districts should be addressed for property tax relief purposes.

Response

DOR disagrees. The Office of the Comptroller General is the appropriate agency to promulgate regulations regarding the manner in which residential parcels located in tax incremental financing districts (TIF) should be addressed for property tax relief purposes. DOR guidance in TIF issues as related to residential property tax relief has been withdrawn at the request of the Comptroller General, although he has indicated his concurrence in DOR's earlier position.

Recommendations 8 - 11

Response

DOR has no comment on these Recommendations.

Recommendation 12

The South Carolina Department of Education should seek clarification from the General Assembly as to which compliance standard should apply to expenditures from property tax relief funds, in order to ensure that accounting controls are appropriate.

Response

Although the statute does not permit the inclusion of bonded indebtedness or capital construction for purposes of calculating the amount due, the statute does not restrict a school district's expenditure of those funds to exclude those purposes. Otherwise, DOR has no comment.

Recommendation 13

If the General Assembly decides to retain the current system, it should consider amending state law to clearly delineate areas of jurisdiction for the Department of Revenue and the Office of the Comptroller General. All agencies involved should implement standard procedures and consistent controls in administering the mechanics of the reimbursement process.

Response

DOR agrees with the concept of clear delineation of agency jurisdiction. DOR did establish standard procedures and controls in its jurisdictional areas for the property tax relief program.

Recommendation 14

The Joint Tax Study Commission should review alternative systems used in other states with the objective of simplifying South Carolina's residential property tax relief process and making it more efficient and accountable.

Response

DOR and the Comptroller General's Office are already working on an overall review of local government finance. Otherwise, DOR has no comment on this Recommendation.

Recommendation 15

The General Assembly should consider establishing a tax study commission on a permanent basis to review future tax legislation and to provide a forum for tax issues.

Response

DOR has no comment on this Recommendation.

Office of the Comptroller General

May 20, 1999

Mr. George L. Schroeder, Director
Legislative Audit Council
400 Gervais Street
Columbia, South Carolina 29201

Dear George:

As reported in your audit, the Comptroller General's Office requires that each county submit a list of each recipient of the school property tax relief exemption including the owner's name, tax map number, fair market value, assessed value and the amount of tax that was exempted and to be reimbursed to the county treasurer. There are approximately one million of these "accounts" for which we check the mathematical calculations, duplication, etc. As the report correctly points out, the other reimbursement programs administered by this office include an additional quarter of a million accounts which are checked in a similar manner.

The continuing lack of field audits will probably lead to an erosion in the accuracy of the reports as the lack of a threat of audits would decrease the attention and resources committed to the request process. Even a cursory audit has a deterrent effect. As to the present statutes providing the authority to perform such audits, we agree with the report insofar as it points out the duplication in law of general authority provided to the Department of Revenue and the Comptroller General to inspect records. However, this office feels that before any government agency seeks to assume authority, such authority should be clearly stated. An audit process necessary to check the items enumerated in this report will require positions and resources in addition to those now available to state agencies, plus legislative clarification as to jurisdiction.

This office has begun the process of notifying the school districts of the amount of funds requested by and sent to the county treasurer. This is in response to the recommendation in this report.

The report does an excellent job in defining some of the problems and weaknesses existing in a very complicated property tax system today. Because the state has made itself a property taxpayer by virtue of direct reimbursement for tax losses in granting the exemption, it is exposed to the same problems and weaknesses in the system as other taxpayers at the local level. There has been ongoing formal dialog between the Comptroller General's Office, the Department of Revenue, the University of South Carolina and Clemson University for the last few years as to measures that could be taken to mitigate at least some of the problems. This prompted this office to propose a legislative initiative to suggest reforms of the entire local funding system. Hopefully, the General Assembly will continue its favorable response to the proposal and meaningful solutions can be brought back to them for consideration. This would include recodification of property tax statutes, an overview of how the state now funds the local entities and a broad based look at various alternatives. This would be in line with your recommendations that the General Assembly establish a study commission to provide a forum for tax issues.

Because a number of recommendations were made which call upon the General Assembly to provide legislative remedies, this office stands ready to assist in that task in whatever capacity that the General Assembly finds most useful and helpful.

Sincerely,

JAMES A. LANDER

State Department of Education

May 20, 1999

Mr. George L. Schroeder
Director
Legislative Audit Council
400 Gervais Street
Columbia, South Carolina 29201

Dear Mr. Schroeder:

Thank you for the opportunity to comment on the audit entitled *A Limited-Scope Review of the Residential Property Tax Relief Program*. The following comments are offered:

1. Recommendation 8 states that the Department of Education should review the distribution of property tax relief funds for tax years 1996-1998 and reconcile cases where funds may have been inaccurately disbursed. The Department will be glad to review the working papers of this audit and coordinate with those agencies that have the proper authority to reconcile any discrepancies. The Department will develop recommendations to assist in the resolution of disbursement discrepancies.
2. Recommendation 12 concerns the accounting controls over the expenditures of property tax relief funds. The State Department of Education uses the standard accounting system in conformance with generally accepted governmental accounting standards and complies with the current federal accounting handbook. The present audit standard establishes that property tax relief funds are not used for debt services and school building expenditures. In addition, the State Department of Education Audit Guide includes directives from the Department of Revenue for independent auditors to insure compliance with the requirements in Section 12-37-251(A)(1). Therefore, a separate subfund is not necessary to account for expenditures charged to the property tax relief funds. Standard accounting procedures assume that state dollars are transferred to the Debt Service and School Building Funds before the transfer of any local funds. This procedure is necessary for any governmental standard accounting system where expenditures are not identified by source of funds (federal, state, local). While \$33 million was transferred to the debt service and school building funds, this transfer figure represents slightly over one percent of the total 1996-97 school district general fund expenditures of \$2.6 billion.

As stated in the report, "state law appears, however, to authorize audits by both the Department of Revenue and the Comptroller General's office." Since the Department of Education has no direct statutory audit responsibility for the property tax relief funds, any clarification needed from the General Assembly should be initiated by the entities that have the audit responsibility. However, the Department of Education will cooperate in any way to assist the agencies in maintaining fiscal accountability, including inclusion of audit procedures in its audit guide to school districts. Any findings of non-compliance may be reported to the responsible agency(ies) as directed.

Thank you for the opportunity to provide comments.

Sincerely,

Elmer C. Whitten, Jr.
Deputy Superintendent
Division of Finance and Operations

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